IN THE
SUPREME COURT OF THE UNITED STATES

No. 76-7231

OCTOBER TERM, 1976

DONALD B. ROSS, *Petitioner*

vs.

RICHARD MORALES, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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CITATIONS

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No.

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DONALD B. ROSS, *Petitioner*

vs.

RICHARD MORALES, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

The petitioner Donald B. Ross respectfully prays that a writ of certiorari issue to review the judgment and opinion

of the United States Court of Appeals for the Tenth Circuit entered in this proceeding on August 27, 1976.

OPINIONS BELOW

The opinion of the court of appeals is reported at 541 F.2d 233, and is reproduced in Appendix A hereto. The opinion of the United States District Court for the Northern District of Oklahoma is unreported and is reproduced in Appendix B hereto.

JURISDICTION

The judgment of the Court of Appeals for the Tenth Circuit was entered on August 27, 1976. No petition for rehearing was filed. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED FOR REVIEW

Is the giving of 3,416 warrants and $9.00 for each warrant in exchange for 3,416 shares of comon stock a "purchase" within the meaning of § 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78p) when:

(1) All warrantholders possess the right to exchange one warrant and $9.00 for one share of common stock anytime prior to the expiration date;

(2) The holders of 98% of such warrants do exercise their warrants;

(3) Warrants are being traded over-the-counter at a price equal to the price of the common stock, minus $9.00; and

(4) The exchange occurs within one month of the expiration date of the warrants, at which time all warrants, unless previously exchanged, are to be automatically converted into one-half share of common stock?

STATUTORY PROVISIONS INVOLVED

United States Code, Title 15, Section 78c(a)(11):

> (11) The term "equity security" means any stock or similar security; or any security convertible, with or without consideration, into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any other security which the Commission shall deem to be of similar nature and consider necessary or appropriate, by such rules and regulations as it may prescribe in the public interest or for the protection of investors, to treat as an equity security.

United States Code, Title 15, Section 78p(b):

> (b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such

security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

STATEMENT OF THE CASE

At all times relevant to this action, petitioner was Financial Vice-President of MAPCO, Inc. ("MAPCO"). Under a prospectus dated March 17, 1964, MAPCO issued 306,450 warrants. By the terms of the issuance one warrant plus $9.00 could be exchanged for one full share of MAPCO common stock through March 31, 1972. Any warrants not so exchanged were to be automatically converted into one-half share of MAPCO common on April 1, 1972, the date of

expiration of the warrants. Out of the total issuance all warrants except 5,486 (1.79%) were exercised by the holders thereof prior to the expiration date.

MAPCO was at all times from 1964 forward a listed stock on the New York Stock Exchange. The warrants had an anti-dilution clause whereby the warrantholders were protected against the issuance of MAPCO common stock at a consideration of less than $18.00 per share. At all times pertinent hereto, warrants were traded in the over-the-counter market at a price equal to the price of the common stock, minus $9.00.

During the period from March 1964, the date of initial issuance of the warrants, to a time six months prior to January 1, 1972, the petitioner acquired 3,616 warrants of MAPCO. In February and March, 1972, petitioner disposed of his warrants in the following manner:

Date	Warrants Exercised	Warrants Sold to Third Party	Shares of Common Received	Shares of Common Sold
Feb. 28	200		200	200
Feb. 29	100		100	100
Mar. 6	200		200	200
Mar. 9	400		400	400
Mar. 23		200		
Mar. 24	2,516		2,516	
Totals	3,416	200	3,416	900

On February 28, 1972, MAPCO common stock closed at $41.00, and on March 24, 1972, the last day of the subject transactions, MAPCO common closed at $43.25. To effect the conversion of the 3,416 warrants into common stock, petitioner either furnished his broker the required $9.00 per warrant or drew upon the balance in his brokerage account. The 900 shares of common stock obtained through the first four transactions went to the broker in its street name and were sold through the New York Stock Exchange.

Thereafter, plaintiff, Richard Morales, brought this action against petitioner and the nominal defendant, MAPCO, Inc., pursuant to the provisions of § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p (1964).[1] The complaint alleged that the petitioner's selling of the 900 shares[2] of MAPCO common stock and the subsequent acquisition of 2,516 shares of common stock was a "sale and purchase" within six months, at a profit, in violation of § 16(b).

Applying a "pragmatic" test, the district court granted petitioner's motion for summary judgment, holding that the

[1]The action was originally filed on February 22, 1974, in the United States District Court for the Southern District of New York. On June 11, 1974, the case was transferred to the Northern District of Oklahoma on the stipulation and agreement of all the parties.

[2]The original complaint actually alleged the sale of 1100 shares of common stock. After discovering that the transaction of March 23, 1972, was, in fact, a sale of warrants and not common stock, the plaintiff consented to the entry of partial summary judgment deleting the March 23 transaction from those at issue. The number of shares of MAPCO common claimed by plaintiff to have been sold by petitioner was thereby reduced to 900.

transfer of one warrant plus $9.00 was not a "purchase" within the meaning of § 16(b) because, *inter alia*, the warrants were the economic equivalents of the common stock, all warrantholders stood in an equal position, there was no possibility of speculative abuse of "inside" information, and the transactions were of an involuntary nature.

The court of appeals reversed, holding that under either an "objective" or "pragmatic" test, the transactions were within the purview of § 16(b).

ARGUMENT

The decision below presents a clear conflict in principle with the decisions of other courts of appeals and of this Court as to the proper interpretation of § 16(b) of the Securities Exchange Act of 1934.

The purpose of § 16(b) is to protect the public "by preventing directors, officers, and principal stockholders of a corporation . . . from speculating in the stock on the basis of information not available to others." Senate Report No. 792, 73d Cong., 2d Session, 9 (1934). In *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973), this Court stated that in deciding whether borderline or "unorthodox" transactions are within the reach of the statute, courts should follow a "pragmatic" approach. The inquiry under this approach is whether or not the transaction could possibly lend

itself to the types of speculative abuse that the statute was designed to prevent. Petitioner contends that the transaction in question — the conversion of warrants into common stock — was not one that could possibly have given rise to speculative abuse, that the court of apeals did not follow a "pragmatic" approach in reaching its conclusion to the contrary, and that the court of appeals' decision is in direct conflict in principle with *Ferraiolo v. Newman*, 259 F.2d 342 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959), and *Petteys v. Butler*, 367 F.2d 528 (8th Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967).

In *Ferraiolo*, one of the "pragmatic" approach cases referred to in *Kern County, supra*, 411 U.S. at 594 n.26, the Court of Appeals for the Sixth Circuit held that a director had not made a "purchase" within § 16(b) by converting preferred stock into common stock, and was therefore not liable for the profits realized by the sale of the common stock within six months. As in the instant case, the preferred stock had an anti-dilution clause to protect against dilution of the value of the preferred. Both the preferred and the common were listed on the New York Stock Exchange, and, because of its undilutable conversion privilege, the preferred had been selling at a price equivalent to the common. When the preferred was called for redemption the director was faced with a choice of permitting his preferred shares to be redeemed at $27.00 a share or converting them into common

shares selling for $36.00. In the court's words, the director "naturally took the latter course as did the holders of more than 99 percent of the outstanding preferred shares." 259 F.2d at 345. While it was true that the director could have sold the preferred shares on the open market instead of converting them, the court said "it can hardly be said that a failure to sell is tantamount to a purchase." 259 F.2d at 346.

In finding that the conversion of preferred into common was not a transaction that could have lent itself to the practices which § 16(b) was enacted to prevent, the court emphasized the following facts: all of the preferred shareholders were treated alike, full disclosure was made to them, the conversion worked no material change in proportional equity ownership, the transaction was in a very real sense involuntary, the preferred and common were economically equivalent, the conversion had none of the economic indicia of a purchase, and the conversion created no opportunity for profit which had not existed since the date of initial issuance of the convertible preferred.

The facts of *Petteys v. Butler*, 367 F.2d 528 (8th Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967), another of the cases cited by this Court in *Kern County* as taking the correct "pragmatic" approach to § 16(b), are quite similar to the situation in *Ferraiolo*. The holding is identical. The directors therein converted preferred stock into common, and sold

the common stock within six months of the conversion. The preferred stock was fully marketable and listed on the New York Stock Exchange. It was protected against dilution, was fully convertible, and at all times maintained a market value equivalent to the common. Redemption of the preferred was called at a price below the market, and the holders of over 99% of the preferred stock converted to common. Following *Ferraiolo*, the Court of Appeals for the Eighth Circuit found that since the transaction could not possibly have lent itself to the speculation encompassed within the purposes of § 16(b), the conversion was not a "purchase" within the purview of the Act's provisions.

In all principal respects, *Ferraiolo* and *Petteys* are identical to the instant case. That those situations involved preferred stock as the underlying security is of no consequence, for a warrant is also an "equity security" within the meaning of § 16(b). 15 U.S.C. § 78c(a)(11). Just as the defendants in *Ferraiolo* and *Petteys* could have disposed of their preferred stock as preferred stock, it is uncontroverted that petitioner, having held his underlying security for more than six months, could have disposed of the 3,416 warrants as warrants without any question of § 16(b) liability whatsoever (see note 2, *supra*). But, to paraphrase the court in *Ferraiolo*, it can hardly be said that petitioner's failure to sell the warrants on the open market was tantamount to a purchase. The courts in *Ferraiolo* and *Petteys* looked through

form to substance. Here, as in those cases, petitioner's conversion of warrants into common stock was also in a very real sense involuntary. Faced with the possibility of substantial economic loss had he allowed the warrants to expire, petitioner "naturally" chose to convert the warrants into common stock, as did the holders of over 98% of all the warrants. Here there was no call for redemption, but there is certainly no substantive difference between the stone wall of redemption and that of expiration of the warrants.

In the instant case, the Court of Appeals for the Tenth Circuit distinguished *Ferraiolo* and *Petteys* on grounds that are completely irrelevant to the inquiry of whether the conversion of the warrants into common stock could possibly have given rise to speculative abuse. For example, the court noted that the transaction in *Ferraiolo* did not require the payment of money while here $9.00 had to be paid with each warrant to obtain a share of common. Petitioner submits this is a distinction without a difference. The $9.00 per warrant payment was established in 1964 and remained constant. There was no "purchase" possible in the sense of the ordinary market purchases which § 16(b) was designed to cover.

Most importantly, this distinction ignores the key finding in *Ferraiolo*, i.e., that the conversion created no opportunity for profit which had not existed since the date of initial issuance. The district court below found, as a matter

of uncontroverted fact, that the market value of the warrants was $9.00 less than the market value of the common stock on the dates of the exchanges, and at least one year prior thereto. Since the petitioner received the same number of dollars from the sale of the stock as he would have received had he sold the warrants as warrants, the warrants and the common stock were economically equivalent. *The court of appeals utterly ignored the fact that the conversion of the warrants into common stock created no opportunity for profit which had not existed since March 17, 1964, the date of initial issuance.* Petitioner contends that the *Ferraiolo* court's reference to "economic indicia" was in fact a reference to the possibility of speculative profit. The following language in *Morales v. Arlen Realty & Development Corp.*, 352 F.Supp. 941, 945 (S.D.N.Y. 1973), supports this interpretation: "The question is whether the acquisition of stock under these circumstances has the indicia of a "purchase" under § 16(b); viz., whether it entailed the possibility of speculation."

Here, and in *Ferraiolo* and *Petteys*, all holders of the underlying "equity security" were in an equal position, as evidenced by the fact that in all three cases the holders of over 98% of the respective securities exchanged for common stock. It was impossible for any warrantholder to have been vulnerable to an unfair advantage simply because petitioner may have had access to "inside" information. And it is the

absence of unfair advantage that is the gravamen of a "pragmatic" inquiry into the possibility of speculative abuse. This the court of appeals completely misperceived. Although the court correctly labeled the conversion of warrants as an "unorthodox transaction," it did *not* follow a "pragmatic" approach in determining whether the exchange constituted a "purchase" within the meaning of § 16(b), as it was required to do in accordance with this Court's decision in *Kern County*. It merely concluded that the transaction had the possibility of speculative abuse of inside information without giving an explanation of the basis for its conclusion. The reason the court of appeals failed to explain its conclusion is because *there was no possibility of abuse*. As the district court stated in the penultimate paragraph of its opinion:

> It is difficult for this Court under the circumstances of this case to determine in any manner how inside information could possibly have lent itself to the speculative abuse prohibited by § 16(b). To find otherwise would penalize a holder of securities for following sound economic principles merely because he serves the corporation in an official capacity, and thereby has access to inside information.

CONCLUSION

The decision of the Court of Appeals for the Tenth Circuit is in direct and irreconcilable conflict in principle with the *Ferraiolo* and *Petteys* decisions from the Sixth and

Eighth Circuits. This Court should grant certiorari, and the judgment of the court of appeals should be reversed with direction to reinstate the judgment of the district court.

Respectfully submitted,

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APPENDIX

APPENDIX A

UNITES STATES COURT OF APPEALS
TENTH CIRCUIT

No. 75-1414

RICHARD MORALES,
Plaintiff-Appellant,

v.

MAPCO, INC., and DONALD B. ROSS,
Defendants-Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OKLAHOMA

(D.C. No. 74-C-271)

David Lopez for Plaintiff-Appellant.

R. Thomas Seymour (Lawrence T. Chambers, Jr., Doerner, Stuart, Saunders, Daniel & Langenkamp, on the brief) for Defendant-Appellee Ross.

Before McWILLIAMS, BREITENSTEIN and DOYLE, Circuit Judges.

BREITENSTEIN, Circuit Judge.

This is a stockholder's derivative action to recover for defendant Mapco short-swing profits said to have been made by defendant Ross, the financial vice president of Mapco. Suit was brought under § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b). The district court granted summary judgment for Mapco and Ross. The stockholder appeals. We reverse.

So far as material, § 16(b) provides:

> "For the purpose of preventing the unfair use of information which may have been obtained by * * * (an) officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase * * * within any period of less than six months, * * * shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such***officer in entering into such transaction***."

The section specifically authorizes a stockholder's derivative action.

The facts are uncontested. In 1964 Mapco issued warrants which were automatically converted into one-half share of Mapco common stock each on April 1, 1972. Alternatively, one warrant plus $9.00 could be exchanged for one full share of Mapco stock prior to the expiration date. The warrants had an anti-dilution clause whereby the warrant holders were protected against the issuance of Mapco common stock at a consideration of less than $18.00 per share.

Ross acquired 3,616 Mapco warrants, and held them for more than six months. Through his broker Ross disposed of the following warrants on the dates shown:

Quantity	*Date*
200	February 28, 1972
100	February 29, 1972
200	March 6, 1972
400	March 9, 1972

Additionally, in March Ross sold 200 warrants to a third person and by the payment of $9.00 per warrant, secured 2,516 shares of Mapco common himself.

Mapco common was a listed stock on the New York Stock Exchange. Warrants were sold and bought in the over-the-counter market. On February 28, the date of the first transaction in question, Mapco common closed at $41.00, and on March 24 at $43.25. The stock reached a high of $52.25 on June 20, 1972.

The stock obtained by the 900 warrants in issue went to the broker in its street name and was sold through the New York Stock Exchange. On the first two transactions, representing a total of 300 warrants, Ross paid to the broker the $9.00 needed to convert each warrant into a full share of common. On the last two transactions, Ross' balance with the broker sufficed to furnish the needed cash. The broker furnished Ross with statements showing the transactions. Ross filed with the Securities and Exchange Commission its Form 4, "Statement of Changes in Beneficial Ownership of Securities," for the months of February and March, 1972. These listed the security as "Warrants: Exercised and Sold as Common," gave the transaction date, and stated the "Amount Sold or otherwise disposed of", as a total of 1100.

Section 16(b) declares its purpose to be the prevention of "the unfair use of information" by a statutory insider obtained "by reason of his relationship to the issuer." Reliance Electric Co. v. Emerson Electric Co., 404 U.S. 418, 422, says that "the only method Congress deemed effective to curb the evils of insider trading was a flat rule taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great." " '(C)onsiderations of intent, lack of motive, or improper conduct' * * * are irrelevant in § 16(b) suits." Ibid. at 424 n. 4. See also Ernst & Ernst v. Hochfelder, ___ U.S. ___, 44 LW 4445,

4459 n. 28; and Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582, 595.

Kern County notes, 411 U.S. at 593, that traditional cash-for-stock transactions within the six-month period are within the purview of § 16(b) and comments that "the courts have wrestled with the question of inclusion or exclusion of certain 'unorthodox' transactions." The court lists, Ibid. at n. 24, as unorthodox transactions those "dealings in options, rights, and warrants." We have here an unorthodox transaction.

In applying § 16(b) the courts have fluctuated from an objective test to a pragmatic test. Under the objective test a mechanical determination is made of whether the type of transaction or class of investor is wholly within or wholly without the purview of § 16(b). The pragmatic test requires examination of each transaction to determine whether an insider has used an opportunity to profit by undisclosed information. A discussion of the two tests is found in Kern County, 411 U.S. at 594 n. 26. Kern County applied the pragmatic test to a merger situation and said that the involuntary nature of the transaction coupled with the absence of speculative abuse resulted in a situation beyond the purview of § 16(b). 411 U.S. at 600. Reliance Insurance applied the statute mechanically. It was concerned with a two-step sale, one step of which was without the six months period. 404 U.S. at 424-425.

Ferraiolo v. Newman, 6 Cir., 259 F.2d 342, cert. denied 359 U.S. 927, involved the conversion of preferred into common stock and, adopting the pragmatic approach, the court held that the transaction was not within § 16(b). The court pointed out equality of treatment, full disclosure, and

no material change in proportional equity ownership. Ibid. at 346. It said that the transaction was involuntary because of the possibility of monetary loss, that the transaction had none of the "economic indicia of a purchase", and that the transaction could not have lent itself "to the practices which Section 16(b) was enacted to prevent." Ibid. In Ferraiolo the transaction did not require the payment of any money by the holder. Here $9.00 had to be paid with each warrant to get a share of common. The preferred stockholder in Ferraiolo had an equity ownership. A Mapco warrant holder had a right to purchase. If the right was not exercised, he received one-half share of common on the expiration of the warrant. A right to purchase is not the equivalent of ownership of the property subject to the right. The warrant did not give ownership until exercised or terminated.

Petteys v. Butler, 8 Cir., 367 F.2d 528, cert. denied, 385 U.S. 1006, was also concerned with conversion of preferred into common and like Ferraiolo is factually distinguishable from the case at bar. Neither Blau v. Max Factor & Company, 9 Cir., 342 F.2d 304, cert. denied 382 U.S. 892, nor Blau v. Lamb, 2 Cir., 363 F.2d 507, cert. denied 385 U.S. 1002, had anything to do with transactions in warrants.

Bershad v. McDonough, 7 Cir., 428 F.2d 693, cert. denied 400 U.S. 992, was concerned with a stock option which was executed, but not exercised, within the six month period. The court held that the date of execution, rather than the date of exercise, controlled and that the transaction was within the purview of § 16(b). In Bershad the parties to the option controlled its terms. The court said that in the circumstances presented "the stock was effectively transferred, for all practical purposes, long before the exercise of the option." Ibid. at 698. In the case at bar, Mapco issued the

warrants and controlled the terms. A warrant holder did not have a right to stock before warrant expiration unless he surrendered his warrant and paid $9.00.

Booth v. Varian Associates, 1 Cir., 334 F.2d 1, cert. denied 379 U.S. 961, was concerned with a transaction in which insiders agreed to exchange or sell stock in one company for stock in another. The transaction was closed in 1962 and within less than six months of the closing date, the insiders sold the stock which they had acquired. The court held the transaction to be within § 16(b). In so doing, it noted that transaction price was the market quotation a day prior to the closing, and said that this feature of the transaction made it "as much as possible *like a market purchase at the time of the closing.*" Ibid. at 4. In the instant case the warrant holder could exercise a warrant and pay $9.00 with full awareness of the current market quotations on Mapco stock.

Kern County points out, 411 U.S. at 593-594, that the statutory definitions of "purchase" and of "sale" are broad "and, at least arguably, reach many transactions not ordinarily deemed a sale or purchase." See also definitions found at 15 U.S.C. § 78c(a)(13) and (14). Section 16(b) covers either "purchase and sale, or sale and purchase" by an insider within a six-month period. Ross sold stock. Before the sale Ross had purchased the stock by surrendering a warrant and paying $9.00. The stock was held in his broker's street name and sold on the exchange. After the sale he acquired more shares in his own name through the use of the warrants and the payment of $9.00 per share, an event constituting another purchase of stock. The sale also was of stock, not of warrants. It makes no difference whether the

purchase occurred before or after the sale. All of the transactions were within the six-month period.

Applying the objective test, the result is the same whether the transactions be considered a purchase and sale or a sale and purchase. Ross was an insider and the transactions were within the statutory period. Section 16(b) was enacted to remedy a congressionally recognized abuse of inside information. It should be liberally construed. The statute removes intent from consideration. Ross' protestations of good faith avail nothing. Speculation as to how the transactions might have been handled to avoid the effect of § 16(b) is of no relevance.

The pragmatic test produces the same result. We do not have an exchange of one security for another. The transactions required Ross to make cash payments. The warrants were not the economic equivalent of the stock because the warrants carried no equity ownership but the stock did. Ross was the financial vice-president of Mapco. The transactions had the possibility of speculative abuse of inside information. Cf. Kern County, 411 U.S. 602. That is enough to bring them within § 16(b).

Reversed and remanded for the entry of an appropriate judgment in the light of this opinion.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT FOR
THE NORTHERN DISTRICT OF OKLAHOMA

NO. 74-C-271

RICHARD MORALES,
Plaintiff,

-vs-

MAPCO, INC., and
DONALD B. ROSS,
Defendants.

David Lopez, New York, New York, and James G. Davidson, Tulsa, Oklahoma, Attorneys for Plaintiff, Richard Morales.

R. Thomas Seymour and Lawrence T. Chambers, Jr., Tulsa, Oklahoma, Attorneys for Defendant, Donald B. Ross; and Eugene G. Bell, Tulsa, Oklahoma, Attorney for Defendant, Mapco, Inc.

MEMORANDUM OPINION

Before H. DALE COOK, United States District Judge

Pursuant to the provisions of §16(b) of the Securities and Exchange Act of 1934, 15 U.S.C. §78(p) (1964), this action was brought as a derivative suit initiated by a shareholder of the nominal Defendant, Mapco, Inc. Section 16(b) prohibits the unfair use of information obtained by a director, officer or principal shareholder as an "insider" of the issuing corporation. Where an "insider" has gained "short swing" profits by a sale or purchase or purchase or sale of

any equity security of the corporate issuer within a period of less than six months, the profits from such unauthorized use of "inside" information are recoverable by the issuing corporation and inure to its benefit.

This action was filed on February 22, 1974, in the United States District Court for the Southern District of New York. The Defendants filed a Motion to Dismiss or Motion to Transfer. On June 11, 1974, without ruling on the Motion to Dismiss, the New York Court transferred the case to the Northern District of Oklahoma on the stipulation and agreement of all the parties.

The pre-trial order filed on October 31, 1974, granted leave to the Defendants to enlarge their Motion to Dismiss into a Motion for Summary Judgment. Pursuant to Rule 56, Federal Rules of Civil Procedure, the Defendants have moved for summary judgment. One of the grounds now asserted by the Defendants in support of their motion is that the two-year Statute of Limitations expired prior to the transfer of the case from the Southern District of New York to this Court. The Defendants assert that the action was wrongfully brought in New York because no venue existed and that the Defendants' motion must be sustained since the Statute of Limitations now bars this action. The expanded Motion for Summary Judgment also asserts that the Defendant, Donald B. Ross, did not dispose of the securities issued to him by Mapco, Inc., in a manner which constituted transactions prohibited by §16(b).

The Complaint alleges that the Defendant, Donald B. Ross, purchased 2,516 shares of Mapco common stock on March 24, 1972, and that he sold 100 shares of Mapco common stock on February 29, 1972, 200 shares on February 28,

1972, 200 shares on March 6, 1972, 400 shares on March 9, 1972, and 200 shares on March 23, 1972, while serving as Financial Vice-President of Mapco, Inc. In support of their Motion for Summary Judgment the Defendants admit that the transactions alleged in the Complaint are true except that the transactions alleged do not constitute a sale and purchase as proscribed by §16(b).

The Plaintiff responded to the Defendants' Motion for Summary Judgment with a brief wherein the Plaintiff consents to a partial summary judgment as to the transaction of March 23, 1972, concerning the disposition of 200 warrants. The Plaintiff stands on the position that the remaining transactions constitute a "sale and purchase" and that the Defendant, Ross, is indebted to the issuing corporation for the unauthorized profits which he gained as an "insider". The Plaintiff asserts that the record will support summary judgment in favor of the Plaintiff as to the remaining issues before the Court. (Pages 2 and 34 of Plaintiff's Memorandum in Opposition to Motion for Summary Judgment).

On April 3, 1975, hearing was held before the Court. Counsel for the parties presented arguments on all issues pending in the case. By agreement of the parties the deposition of Donald B. Ross was admitted into the record to be considered as evidence by the Court in resolving the questions presented. Both Plaintiff and Defendants declared an intent to rest upon the facts in the record. In addition to the consideration of counsels' statements of resting on the record, the Court has determined that this cause is properly before the Court on a Motion for Summary Judgment since no dispute exists as to the material facts provided in the record. *Frey* v. *Frankel*, 361 F2d 437 (10th Cir. 1966); *Norton* v. *Lindsay*, 350 F.2d 46 (10th Cir. 1965); *Singer* v.

Rehm, 334 F.2d 240 (10th Cir. 1964). The Court has carefully considered both the oral and written arguments of counsel, and has reviewed the entire record and is fully advised in the premises. Each Motion for Summary Judgment has been cautiously evaluated. For the following reasons the Court is convinced that summary judgment should be granted:

1). The parties have expressly declared an intent to rest entirely on the record.

2). Both parties have stipulated that they have no evidence to controvert issues which normally constitute triable fact issues, *H. B. Zachry Co.* v. *O'Brien*, 378 F.2d 423 (10th Cir. 1967).

3). The Plaintiff has no evidence to dispute the Defendants' contention that the value of the warrants exchanged by the Defendant, Ross, is the value of Mapco Common Stock on the date of the exchange. When the statements of value are viewed in a light most favorable to the position of the Plaintiff no issue of fact is raised to controvert the value as established by the affidavit and deposition filed in the record. *United States* v. *Diebold*, 369 U.S. 654 1962); *American Mfrs. Mut. Ins. Co.* v. *American Broadcasting — Paramount Theatres, Inc.*, 388 F.2d 272 (2nd Cir. 1967).

4). The interpretation of the terms "sale and purchase" is a proper determination of the Court. *Kern County Land Co.* v. *Occidental Petroleum Corp.* 411 U.S. 582 (1973).

The legal issues before the Court arise from the following facts. During the period from March 17, 1964, the date

of the initial issue of the warrants, to a time six months prior to January 1, 1972, the Defendant, Donald B. Ross, purchased 3616 warrants of Mapco, Inc. Under the terms of the initial issue the warrants were automatically converted into one-half share of Mapco common stock on April 1, 1972, the date of expiration. As an alternative one warrant plus $9.00 could be exchanged for one full share of Mapco common stock prior to the expiration day. The warrants had an anti-dilution clause whereby the warrantholders were protected against the issuance of Mapco common stock at a consideration of less than $18.00 per share. During the period of February 29, 1972, and March 23, 1972, the Defendant, Ross, while serving as Financial Vice-President of Mapco, Inc., exercised 1100 warrants and sold 900 shares of Mapco common stock through the New York Stock Exchange. On March 24, 1972, Ross exercised 2516 warrants and received 2516 shares of Mapco common stock. These facts are undisputed.

The Court must first consider whether this action was brought within the period allowed by the Statute of Limitations. In order to resolve this question a determination as to proper venue in the New York Court must be made. The Complaint was filed in the New York Court on February 22, 1974. The transaction last complained of by the Plaintiff occurred on March 9, 1972. The case was transferred to the Northern District of Oklahoma on the 11th day of June, 1974. Since the case was transferred after the Statute of Limitations had run, the question of whether the cause was properly brought within the statutory period is dependent upon the New York venue. If venue did not lie in the New York Court then the application of §16(b) to these facts is a futile engagement.

Section 27 of the Securities and Exchange Act of 1934

(15 U.S.C. §78aa) provides in part:

> "The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter . . . . Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found."

In *Blau* v. *Lamb*, 20 F.R.D. 411 (S.D.N.Y. 1957) the court overruled the defendant's motion to dismiss for lack of jurisdiction over the person or the subject matter in an alleged 16(b) violation though none of the defendants were found or were inhabitants or transacted business in the Southern District of New York. The plaintiff was a Delaware Corporation with the principal place of business in Ohio and all of the defendants were domiciled in Ohio. The court founded jurisdiction on the clause of §78aa which states, ". . . act or transaction constituting the violation occurred," and concluded that transactions on the New York Stock Exchange were enough contact to provide the New York court with jurisdiction.

In an action for attorney's fees for recovery of short swing profits in *Blau* v. *Tool Research & Engr. Corp.*, 330 F.

Supp. 1374 (S.D.N.Y. 1971), the court said in the following language that this action could be maintained in the district where the transactions were effectuated and where the claim arose:

> "The salient fact, ... , is that the unlawful insider short-swing transactions were effectuated over the American Stock Exchange, located in the Southern District. Although trading over a national exchange is insufficient to satisfy the transaction of business clause of §78aa, . . . , it appears settled that the consummation of an illegal short-swing transaction over a national exchange satisfies the act or transaction constituting the violation clause of §78aa."

Numerous cases have held that if such an act is committed venue lies. See, e.g., *Peyser* v. *Meehan Fund, Inc.*, 264 F.Supp. 1 (S.D.N.Y. 1966); *Sher* v. *Johnston*, 216 F.Supp. 123 (S.D.N.Y. 1963); *Blau* v. *Lamb*, supra. In authorizing the brokerage firm of Harris, Upham & Co. to dispose of the warrants, the defendant, Ross, clearly set in motion the events which resulted in the acts and transactions through the New York Stock Exchange which resulted in the disposition of the defendant's stock. In authorizing his agent, Harris, Upham & Co., to dispose of his warrants, Ross subjected himself to the contacts with New York incurred by his agents in effecting the transactions. (Exhibit A of the Answers to Interrogatories Addressed to Defendant Donald B. Ross; Page 7 of The Deposition of Donald B. Ross).

It is the finding of the Court that this action was properly brought in the Southern District of New York, that the New York Court had proper venue over this cause, and, therefore, that this Court has appropriate jurisdiction over

the subject matter and the parties since the action was instituted prior to the expiration of the Statute of Limitations and the Defendants have been properly served with process.

Having determined that venue was proper in New York and that the Court has jurisdiction over this matter, the Court next considers the question of whether these transactions constitute a violation of §16(b). The latest teaching from the United States Supreme Court on the application of §16(b) is *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973) where Mr. Justice White distinguished the application of §16(b) when the transaction is "traditional" from those transactions which are unorthodox.

> "Although traditional cash-for-stock transactions that result in a purchase and sale or a sale and purchase within the six-month, statutory period are clearly within the purview of §16(b) the courts have wrestled with the question of inclusion or exclusion of certain 'unorthodox' transactions." *Kern* at 593.

In the facts before the Court and upon which facts the parties have rested, the Defendant, Ross, submitted $9.00 plus one warrant to his broker who exercised rights conferred by the warrant and received a share of Mapco common stock. The common stock was then sold and the proceeds applied to the Ross account. This transaction does not fall under the traditional "cash-for-stock" purchase. The Defendant owned the warrant at least six months prior to any of the exchanges which are the subject of this lawsuit. He did not tender the purchase price in cash in order to acquire the common stock but rather tendered $9.00 plus one warrant as the terms of the issue dictated and received one share of Mapco common

stock. Upon receiving the stock the broker sold it and credited the proceeds to the account of Ross. Clearly this transaction falls within the classification of "unorthodox" as provided in *Kern* and requires that the pragmatic test be utilized to determine whether these transactions are prohibited. The pragmatic test directs the Court to look at all of the circumstances in determining whether §16(b) applies. *Roberts* v. *Eaton*, 212 F.2d 82 (2nd Cir. 1954), cert. denied, 348 U.S. 827 (1954); *Ferraiolo* v. *Newman*, 259 F.2d 342 (6th Cir. 1958), cert. denied, 359 U.S. 927 (1959); *Blau* v. *Max Factor Co.*, 342 F.2d 304 (9th Cir. 1965), cert. denied, 382 U.S. 892 (1965); *Blau* v. *Lamb*, 363 F.2d 507 (2nd Cir. 1966), cert. denied, 385 U.S. 1002 (1967); *Petteys* v. *Butler*, 367 F.2d 528 (8th Cir. 1966), cert. denied, 385 U.S. 1006 (1967).

The facts of each case must be set in the context of the guidelines of *Kern*.

> "In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent-the realization of short-swing profits based upon access to inside information—thereby endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits." *Kern* at 594-595.

The terms "sale and purchase" must be interpreted in light of the activity which may provide the speculative abuse which the Congress intended to prevent. *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418 (1972). In applying the terms "sale and purchase" to the facts, the Court must consider the standard espoused in *Ferraiolo*, supra, which states:

> "Every transaction which can reasonably be defined as a purchase will be so defined, if the transaction is of a kind which can possibly lend itself to speculation encompassed by Section 16(b)." *Ferraiolo* at 345.

The Court must now apply the law as set out above to the facts of this case. The warrants held by the Defendant, Ross, were convertible at any time prior to April 1, 1972 for one share of Mapco common stock. The convertibility of the warrants was protected against dilution by a provision which prevented the issuance of Mapco common stock at a consideration of less than $18.00 per share. The uncontroverted affidavit of Alan C. Greenberg, a general partner of Bear, Stearns & Co., the principal underwriters of these warrants, supports the premise that the value of the warrants plus $9.00 equaled the value of Mapco common stock on the dates of the exchanges and at least one year prior to these dates when the affiant states that the firm of Bear, Stearns & Co. would have exchanged the warrants or paid cash for the warrants on the basis of the market value of the Mapco, Inc., common stock. (Exhibit A of Defendant Donald B. Ross' Brief in Support of Expanded Motion to Dismiss). The deposition of Donald B. Ross supports the conclusion that the value of the warrants was equal to the value of the common stock on the date of the exchange when the witness states that he would have received the same number of dollars from Bear, Stearns & Co. that he received from Harris, Upham & Co. if he had sold only warrants as warrants to Bear, Stearns & Co. (Page 12 of The Deposition of Donald B. Ross). Ross held the economic equivalent of the Mapco common stock. A transfer of the warrant plus $9.00 for one share of Mapco common stock cannot be considered a "purchase" where the securities involved were

economic equivalents. The conversion did not result in a material change in the proportional equity ownership of Mapco or in an opportunity for profit which had not existed since March 17, 1964. *Ferraiolo*, supra, at 346.

The exchange of the warrant for Mapco common stock and the subsequent sale of common stock was a simultaneous transaction. The brokerage firm of Harris, Upham & Co. held the warrant as cover for the equivalent of the securities sold. Though the warrants were held in street name, the brokerage firm was in a position to order them out in street name or the name of the purchaser. (Page 14 of The Deposition of Donald B. Ross). In the transactions subject to this suit the warrants were ordered out in street name, the common stock credited to the street name and then sold with the proceeds credited to the account of Ross as if he had sold warrants. The transaction in exchanging warrants for stock was simultaneous with the sale of stock so that no opportunity to speculate between the exchange of the warrant and the sale of the equivalent stock presented itself. It is the simultaneous nature of this transaction that takes it out from under the speculative abuse which Congress intended to prevent in enacting §16(b). Had Ross held the stock for any period of time after the exchange, a strong presumption of speculative abuse would immediately exist. With the exchange and sale occurring in one unified transaction such as is present here, there exists no possibility for speculative abuse. It is interesting to note that Mapco common stock closed at $41.00 on February 28, 1972, the first day of the subject transactions. On March 24, 1972, the last day of the subject transactions, the stock had gained 2-1/2 points in closing at 43-1/4. The stock reached a high of 52-1/4 on June 20, 1972, and on September 25, 1972, six months after the

last of the subject transactions, the stock closed at 24-3/8 with a stock split having occurred on September 14, 1972. (Defendants' Exhibit 3 of The Deposition of Donald B. Ross). These listings show that Ross would have gained substantially by holding his common stock until June of 1972 where he would have gained more than ten points over his first sale of common stock. If he had held the stock until six months after the final exchange of warrants, he stood to gain more than seven points over his first exchange. The use of "inside" information would appear under these facts to have prompted Ross to hold for higher gain. These conditions strongly suggest that no speculative abuse existed in the exercise of the warrants and simultaneous sale of the stock.

Each warrantholder held the power to receive the market value of the Mapco common stock at least one year prior to the expiration date. (Affidavit of Alan C. Greenberg). There was no opportunity for speculative abuse where all warrantholders were subject to market fluctuations. Ross held slightly in excess of 1% of all the warrants which were issued. (Exhibit B of Defendant B. Ross' Brief in Support of Expanded Motion to Dismiss). Any "inside" information gained by Ross because of his position as Financial Vice-President would have been ineffectual under these circumstances to control the market for his own advantage.

According to the uncontroverted affidavit of G. Dean Cosgrove, Treasurer of Mapco, Inc., less than 2% of those warrants issued remained unexercised as of March 31, 1972. (Exhibit B, supra). All warrantholders were thus in the same position as Ross. Substantially all of the warrantholders converted rather than to suffer a considerable and needless loss. No warrantholder was vulnerable to an unfair

advantage because Ross may have had access to "inside" information. At the time during which Ross converted his warrants he had little choice to prevent a substantial economic loss. He began his conversion within a month of the expiration date. The exchange was involuntary as the exercise of nearly all of the issued warrants indicates. *Petteys*, supra. Since all of the warrantholders stood in an equal position, no advantage was taken of them by the conversion of the warrants held by Ross. *Shaw* v. *Dreyfus*, 172 F.2d 140 (2nd Cir. 1949) cert. denied, 337 U.S. 907 (1949). To have waited beyond the expiration date would have rendered the warrant economically unequal to the common stock and resulted in a considerable loss to the holder. It is difficult for the Court under the circumstances of this case to determine in any manner how inside information could possibly have lent itself to the speculative abuse prohibited by §16(b). To find otherwise would penalize a holder of securities for following sound economic principles merely because he serves the corporation in an official capacity, and thereby has access to inside information.

Where there is no possibility of speculative abuse of "inside" information, an involuntary nature to the transaction, a simultaneous transfer of warrants for stock and sale of stock, and an economic equivalent between the warrant and the stock received in the exchange such as exists in this case, §16(b) should not be applied to render an injustice to the defendant. The Motion of Mapco, Inc., and Donald B. Ross for Summary Judgment should be and is hereby sustained.

It is so Ordered this 10th day of April, 1975.

/s/ H. Dale Cook
United States District Judge

No. 76-723

IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

DONALD B. ROSS,

Petitioner,

v.

RICHARD MORALES,

Respondent.

ON A PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The Court of Appeals' opinion is reported at 541 F.2d 233. Its text appears at Petitioner's Appendix A-1 to A-7. The opinion of the United States District Court For The Northern District of Oklahoma is not officially reported but is reported unofficially at 1976 CCH Fed. Sec. L. Rep. ¶ 95,704. Its text appears at Petitioner's Appendix A-8 to A-20.

JURISDICTION

The interlocutory judgment of the Court of Appeals with respect to liability only was entered on August 27, 1976. The petition for a writ of *certiorari* was filed on November 23, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED FOR REVIEW

1. Whether the Court of Appeals for the Tenth Circuit was correct in finding, through application of both the so-called "mechanical" and "pragmatic" tests of liability under § 16(b) of the Securities Exchange Act of 1934, 28 U.S.C. § 78p(b) [the "Act"], that voluntary exercises of warrants to purchase stock by a corporate insider followed or preceded within six months by sales of the resulting stock give rise to liability under the Act.

2. Whether cause exists for interlocutory review by way of *certiorari* of the finding of liability by the Court of Appeals for the Tenth Circuit prior to completion of District Court proceedings with respect to damages, entry of final judgment and appellate review thereof.

STATUTE INVOLVED

Section 16(b) of the Securities Exchange Act of 1934, as amended, 28 U.S.C. § 78p(b), provides in part:

> (b) . . . any profit realized by [any beneficial owner, director or officer] from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director or officer . . . .

STATEMENT OF THE CASE

Petitioner, while Financial Vice President of MAPCO, Inc., exercised warrants to purchase 3416 shares of MAPCO, Inc. common stock by surrendering such warrants together with the required exercise price; and within six months

before or after such warrant exercises, he sold 900 shares of such stock. Respondent filed suit as a shareholder to recover the profits realized in these transactions for the benefit of MAPCO, Inc. after the management of MAPCO, Inc. had declined to enforce the rights of the company against one of its members.

The District Court misconstrued the statutory language of Section 16(b), *supra,* reading it to require a demonstration of the existence of an actual abuse of inside information (Petitioner's Appendix A-8), and upon determining that such demonstration had not been made and that a warrant which required a substantial cash payment to be exercised was "the economic equivalent" of the stock issuable upon exercise, found for the Defendant-Petitioner.

The Court of Appeals for the Tenth Circuit reversed, finding from the facts in the record ample *opportunity* and *possibility* for speculative abuse (as opposed to its proven actuality); and further finding that a warrant which carries a right to purchase common stock at a favored price cannot be deemed the economic equivalent of the common stock issuable upon exercise and payment. (Petitioner's Appendix A-7).

ARGUMENT

1. The petition calls upon the Court to apply settled principles governing Section 16(b) to the facts of this case. This the Court of Appeals has already done and so narrow a question warrants no further review.

2. The decision of the Court of Appeals for the Tenth Circuit is not in conflict with governing authority in any other Circuit. Exercises of warrants or options by persons having the potential for access to inside information, where

the timing of such exercises is within their control, are universally regarded as purchases of the securities issuable upon exercise. See *Shaw* v. *Dreyfus*, 172 F.2d 140, 142 (2d Cir. 1949), *cert. den.*, 337 U.S. 907; *Clamitz* v. *Thatcher Manufacturing Co.*, 158 F.2d 687, 692 (2d Cir. 1947), *cert. den.*, 331 U.S. 825, (dictum); *MacDonald* v. *Commissioner*, 230 F.2d 534, 540 (7th Cir. 1956); *Walet* v. *Jefferson Lake Sulphur Co.*, 202 F.2d 433 (5th Cir. 1953), *cert. den.*, 346 U.S. 820, Securities Act Release 4509 (1950), Loss, *Securities Regulation*, 1076, 1079.

The Court of Appeals distinguished, upon the facts, the purported conflicts raised by *Ferraiolo* v. *Newman*, 259 F.2d 342 (6th Cir. 1958) *cert. den.*, 359 U.S. 927 (1959) (Petitioner's Appendix A-4 and A-5); and by *Petteys* v. *Butler*, 367 F.2d 528 (8th Cir. 1966) *cert. den.*, 385 U.S. 1006 (1967) (Petitioner's Appendix A-5). It applied to the facts before it both the mechanical or objective test and the pragmatic test of liability (Petitioner's Appendix A-4 to A-7).

3. Petitioner's application for *certiorari* is premature in that it seeks interlocutory review of the Court of Appeals' finding of liability prior to completion of District Court proceedings with respect to assessment of damages, entry of final judgment and appellate review of that final judgment. The Petitioner betrays no awareness of the extraordinary nature of his request. No compelling fact or argument in support of so radical a departure from normal procedure has been advanced by Petitioner. Respondent knows of the existence of none.

CONCLUSION

No conflict among the Circuits is here presented. The only issues advanced in the Petition relate to narrow application of settled principles to facts in the record. No final judgment has been rendered or subjected to appellate review. The petition for a writ of *certiorari* should be denied.

Respectfully submitted,

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December, 1976